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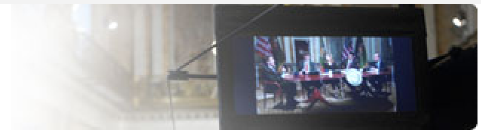

Remarks by Treasury Under Secretary for International Affairs David H. McCormick at the Tuck Global Capital Markets Conference

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Open Investment and America's Prosperity

Hanover , N.H. – Thank you, Paul for that warm introduction. I would like to thank you, Matt Slaughter, and the Tuck School for inviting me to this conference, and to all of you for joining us today.

The leadership here at the Tuck School was prescient, even clairvoyant, in scheduling a conference on global capital markets at this time – the timing could not be better. In recent weeks, we have seen the biggest stock market declines since 9/11. Volatility has spread to European, East Asian, and Indian capital markets, casting cold water on the notion of decoupling. And leaders around the world are resetting their expectations for how quickly their economies and the rest of the world will grow. We don't need our Bloomberg screens or Wall Street Journals to know that the gains enjoyed from globalization over the past decade may be difficult to replicate in the next one. All of us in this room have an obligation to understand the nature of the challenge and to rise to meet it.

The Case for Investment

Investment flows are one of the most important ways our economy benefits from globalization. As President Bush recognized in his May 2007 Open Economies Policy Statement, "a free and open international investment regime is vital for a stable and growing economy, both here at home and throughout the world."

The data supporting this assertion are staggering. While the headlines tend to focus on trade in goods and services, these flows are dwarfed by cross-border investment transactions. In 2006, for example, gross cross-border transactions in long-term securities involving U.S. and foreign residents totaled $52 trillion, compared to only $3.6 trillion in U.S. exports and imports of goods and services.

What holds true for the United States holds true globally. Between 1991 and 2005, the World Bank's measure of global private capital flows increased by 500 percent, almost twice as fast as trade flows. Looked at another way, daily foreign exchange transactions have increased over 26 years from $880 billion in 1992 to $3.2 trillion today. If we include transactions in financial derivatives, that figure rises to over $5 trillion daily.

The benefits we gain from international investment in the United States are as important as its volume. You know the argument, and Matt's recent insourcing study has provided great analytical underpinning to it, but the story bears repeating. International investment in the United States fuels U.S. economic prosperity by creating well-paid jobs, bringing new technology and business methods, helping finance U.S. priorities, and providing healthy competition that fosters innovation, productivity gains, lower prices, and greater variety for consumers.

In 2006, foreign-owned firms contributed almost six percent of U.S. output and 14 percent of U.S. R&D spending. They re-invested over half of their U.S. income – $71 billion – back into the U.S. economy and made 13 percent of U.S. tax payments. This activity, in turn, creates jobs. Nearly one in 10 U.S. private sector jobs, in fact, are created by those foreign firms. U.S. affiliates of foreign firms employ over five million Americans and generate some five million more jobs indirectly. And these are good jobs, paying on average 25 percent higher wages.

At the same time, the U.S. economy and U.S. workers benefit from the ability of American firms to invest abroad. In 2005, U.S. multinationals exported $491 billion, accounting for more than 54 percent of total U.S. exports. Nearly half of this amount, $189 billion, was exported to their foreign affiliates. Moreover, U.S. multinationals accounted for over half of U.S. productivity growth between 1977 and 2000.

That's the good news. That is why President Bush, in his May 2007 open economies statement, also pledged that, "the United States unequivocally supports international investment in this country and is equally committed to securing fair, equitable, and nondiscriminatory treatment for U.S. investors abroad."

Now for the challenge that brings us together today. Simply stated, the gains won thus far cannot be taken for granted. Indeed, they are under threat. Globalization can sometimes result in winners and losers. For example, the same forces that create the benefits from global capital markets also create the risks inherent in global interdependence. As a consequence of this phenomenon, some actors, such as China and the oil-producing states, have gained new prominence through their trade flows, accumulation of reserves, and creation of sovereign wealth funds, shifting perceptions of the balance of economic power. Globalization has enabled the pie to grow much bigger for all, but the benefits of globalization are unfortunately viewed by some as a zero-sum game, fueling the forces of protectionism.

The risks are real. Protectionist pressures leading to greater restrictions on international investment, whether here or abroad, would weaken the United States. We would lose out to other countries in the competition for international investment and the benefits it brings. This would present Americans with painful choices regarding taxes, government programs, and personal savings and consumption. It would also have broader international implications. If America turned inward, other countries could, and likely would, impose restrictions on U.S. investors, jeopardizing the growing domestic benefits generated by American businesses that operate globally.

And so we are in the midst of a critical debate, and we must individually and collectively press forward to win it. By "winning," I mean protecting and in some cases expanding the principles of openness that have paved the way to our current prosperity. We must avoid the well-known mistakes of the 1930s, in which economic turmoil was met by economic insularity. With this in mind, I'd like to spend the remainder of our conversation touching on three areas in particular where the government's role in investment policy is both important and timely:

- Developing policy responses to the financial market and investment policy issues raised by sovereign wealth funds;
- Addressing the national security aspect of foreign investment in the United States and around the world; and
- Negotiating bilateral investment treaties to give our firms greater access to foreign markets.

Sovereign Wealth Funds

Sovereign wealth funds have garnered the most column inches recently, so let me start with them. Current opinion seems divided as to whether sovereign wealth funds are part of the problem or part of the solution to the challenges we face. Not surprisingly, from my vantage point, the answer is "that depends" – it depends on whether government policies and the practices of sovereign wealth fund managers foster openness and market-based decision-making or insularity and investment with ulterior motives.

While sovereign wealth funds have recently generated significant attention, they have in fact been around for decades. The oldest, in Kuwait and Kiribati, date back to the 1950s. Three of the largest and most respected funds – the Abu Dhabi Investment Authority, Singapore's Government Investment Corporation, and Norway's Government Pension Fund-Global – were founded in 1976, 1981, and 1990, respectively. By 2000, there were about 20 sovereign wealth funds worldwide managing total assets of several hundred billion dollars.

What is new today is the rapid increase in both the number and size of sovereign wealth funds. Twenty new funds have been created since 2000, more than half of these since 2005, bringing the total number to nearly 40 funds that manage $1.9-2.9 trillion in assets with some private sector analysts projecting that sovereign wealth fund assets could grow to $10-15 trillion by 2015.

Two trends have contributed to this ongoing growth. The first is sustained high commodity prices, especially for oil. The second is the accumulation of official reserve assets in non-commodity exporting countries and the subsequent transfer of a portion of these assets to government investment vehicles such as sovereign wealth funds.

To get a better perspective of the relative importance of sovereign wealth funds, it is useful to consider how they measure up against private pools of global capital. Total sovereign wealth fund assets of $1.9-2.9 trillion may be small relative to the $190 trillion in global financial assets as of end-2006, or the roughly $62 trillion managed by private institutional investors. But sovereign wealth fund assets are currently larger than the total assets under management by either hedge funds or private equity funds (estimated at $1.5 trillion and $700 billion, respectively), and are set to grow at a much faster pace.

Sovereign wealth funds can promote financial stability. They are, in principle, long term, stable investors that provide significant capital to the system. They are typically not highly leveraged and cannot be forced by capital requirements or investor withdrawals to liquidate positions rapidly. As public sector entities, sovereign wealth funds should have an interest in and a responsibility for financial market stability. All of this is in addition to the impact on economic growth of the investments themselves.

At the same time, transactions involving sovereign wealth fund investment may raise legitimate national security concerns, as well as a number of non-national security issues. For example, through inefficient allocation of capital, unfair competitive advantage, or through the pursuit of broader strategic rather than strictly economic return-oriented investments, sovereign wealth funds could potentially distort markets. On the financial markets side, sovereign wealth funds can represent large, concentrated, and often non-transparent positions in certain markets and asset classes that have the potential to affect market stability.

An important starting point for any discussion on sovereign wealth funds must begin with the recognition that there is little evidence of any of this behavior. With this in mind, the Treasury Department is taking active steps to better understand, and where appropriate, to act on this developing phenomenon. This is the most effective way to push back on a significant risk associated with sovereign wealth funds – the rise of protectionism.

First, Treasury has taken a number of steps internally and within the U.S. government to enhance our understanding of sovereign wealth funds. Treasury has created a working group on sovereign wealth funds that draws on the expertise of Treasury's offices of International Affairs and Domestic Finance. Treasury's market room is ensuring vigilant, ongoing monitoring of sovereign wealth fund trends and transactions on a real-time basis. Through the President's Working Group on Financial Markets, chaired by Secretary Paulson, we continue to discuss and review these funds. In addition, we have initiated bilateral outreach to ensure an ongoing and candid dialogue with countries with significant sovereign wealth funds and their management. Finally, we provide semi-annual updates to Congress on our sovereign wealth fund-related work in the Report on International Financial and Exchange Rate Policies.

Second, we are reaching out to other countries to make sure that we are all on the same page. For example, last May, Treasury hosted a G-20 workshop on commodity cycles and financial stability which included a session on sovereign wealth funds. At last October's G-7 meetings in Washington, Secretary Paulson hosted a G-7 outreach dinner with Finance Ministers and heads of sovereign wealth funds from eight countries – China, Korea, Kuwait, Norway, Russia, Saudi Arabia, Singapore, and the United Arab Emirates – to build support for a set of best practices for sovereign wealth funds.

Third, Treasury has proposed that the international community collaborate on a multilateral framework for sovereign wealth fund best practices. At the IMF, we are working to develop best practices for sovereign wealth funds that can build on existing IMF guidelines for foreign exchange reserve management. A framework for thinking about best practices might include: investing commercially, not politically; competing fairly with the private sector; promoting international financial stability; and, respecting host country rules.

Understanding that investment is a two-way street, we are encouraging the Organization for Economic Cooperation and Development to identify investment policy best practices for countries that receive foreign government-controlled investment, including investment from sovereign wealth funds. This effort would complement the extensive work already underway at the OECD on open investment and national security. Investment policy best practices should focus on avoiding protectionism, and should be guided by the well-established principles of proportionality, predictability and accountability embraced by the OECD and its members for the treatment of foreign investment. We hope to achieve results later this year that may serve as a touchstone to guide countries that receive sovereign investments.

Committee on Foreign Investment in the United States

On this and broader issues, we are working within the Committee on Foreign Investment in the United States, known as CFIUS, to ensure sovereign wealth fund investments do not harm on our national security. CFIUS, which Treasury chairs, reviews certain foreign direct investments that may raise national security considerations.

National security is paramount, and we take this responsibility very seriously. At the same time, national security must not be used as an excuse for pursuit of protectionist policies, industrial policy, or the creation of national champions. Investment reviews must be strictly limited to genuine national security concerns, not broader economic or national interests. The legal regime governing foreign investments should be predictable, and, when a particular transaction poses genuine risk to national security, the policy response should be fair and proportional to the incremental risk.

Recent reforms have strengthened the CFIUS process and reinforced our longstanding commitment to open investment. Congress made its open investment intention explicit with the passage of the Foreign Investment and National Security Act of 2007, known as FINSA. President Bush also reiterated the U.S. open investment policy at the beginning of an executive order he issued on January 23, 2008, to strengthen the CFIUS process.

The new statute and the recent executive order signed by President Bush maintain CFIUS's focus solely on genuine national security concerns and allow CFIUS to seek risk mitigation measures only when existing laws are not adequate and appropriate. As a result, the CFIUS footprint is small, but very important. In 2007, CFIUS reviewed fewer than eight percent of M&A transactions in the United States involving a foreign acquirer and a domestic firm. Over 80 percent of the transactions that CFIUS reviewed made it through the process within 30 days with only a small minority requiring a second phase investigation or mitigation measures.

We are committed to continuing to streamline the CFIUS process to ensure that it provides needed scrutiny to the small number of investments with national security implications without unduly delaying investments or introducing unpredictability into the system. We are preparing revised regulations to further implement the new law, and as required by Congress, we will also publish guidance in the spring on the types of transactions that have raised national security concerns in the past. This will give investors further insight into the process.

These steps have positioned us well to encourage other countries, such as China, Germany, Canada, and Russia, to not use concerns about national security or sovereign wealth funds to create protectionist barriers to investment. We are setting the example with a measured approach that protects national security while adhering to open investment principles.

Bilateral Investment Treaties

Finally, let me turn to a perhaps less high-profile – but extraordinarily important – way in which we can reinforce an open investment climate. I am referring to U.S. bilateral investment treaties. Bilateral investment treaties, known as "BITs," operationalize U.S. support for open investment, both here and abroad, by locking in open investment policies and ensuring progressive liberalization. They eliminate investment barriers and prevent new barriers from arising.

These treaties support investment liberalization by ensuring a minimum and predictable level of fair and equitable treatment based on customary international law, including protection against denial of justice by courts or administrative tribunals. BITs prohibit costly performance requirements, such as technology transfer requirements; protect the right to remit investment returns; and permit expropriation only in accordance with the standards of international law. Perhaps most importantly, they give investors a right to go to international arbitration to enforce the treaty's commitments, while insulating the U.S. government from investment disputes abroad. I won't go through the whole list of BIT provisions, but I think the business people in this room will agree with me that this basic blocking and tackling is essential to expanding U.S. and international investment flows.

We currently have bilateral investment agreements with 40 countries. Each one is a small step forward in realizing the benefits of globalization with the explicit objective of enhancing the free flow of investment. These are victories for both sides. Studies show that foreign firms bring new products and processes to the host countries, enhancing productivity, bringing new and better jobs, and improving services for domestic firms. By signing a high-standard U.S. BIT, the treaty party sends a clear message that it welcomes U.S. investment and is prepared to stand by enforceable commitments to an open investment regime. As well, by signing a BIT, the United States reinforces its long-standing commitment to an open investment regime.

We are seeking more such victories. Exploratory discussions are underway with rising economic powers such as China, Russia, and India – three of the so-called "BRICS." U.S. firms are already investing in these three markets at a rate two-and-a-half times that with the rest of the world. As a result, between 2001 and 2006, U.S. investment in them rose from $15.4 billion to $41.1 billion. BITs are an important next step to protect these existing investments. They also encourage new flows by providing greater assurances against discriminatory treatment; securing the ability to maintain, operate and expand investments; and ensuring that U.S. companies benefit from policy liberalization in these fast-growing countries.

The Way Forward

Each of the areas I've touched on today – sovereign wealth funds, the CFIUS process, and Bilateral Investment Treaties – is at the forefront of an open investment campaign that must be waged to hold the forces of protectionism at bay. But this campaign is far too big for government alone. We can set the stage, and we can provide the rules. We can cajole and encourage others to take the right steps.

But we need your help. We need your assistance in telling the story about the benefits of open investment. We need your support in reinforcing the importance of reasoned investment policies in areas like sovereign wealth funds, national security reviews and bilateral investment treaties. We need your enthusiasm for advocating your views on investment with policymakers at home and abroad, within Washington and within your homes states. Together, we must make the case to America that open investment is a competitive advantage.

Thank you for your kind attention.

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